No. 14,792.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

JACOB (JAY) PALEY and LILLIAN PALEY,

Respondents.

On Petition for Review of the Decision of the Tax Court of the United States.

BRIEF FOR THE RESPONDENTS.

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BRIEF FOR THE RESPONDENTS.

Opinion Below.

The opinion of the Tax Court [R. 23-25] is reported at 22 T. C. 1236.

Jurisdiction.

This petition for review [R. 26-27] involves federal income taxes for the taxable years 1948 and 1949. On March 20, 1952, the Commissioner of Internal Revenue mailed to the taxpayers notice of deficiencies in the total amount of $36,249.09. [R. 10-17.] Within ninety days thereafter and on May 13, 1952, the taxpayers filed a petition with the Tax Court for a redetermination of the deficiencies under the provisions of Section 272 of the

Internal Revenue Code of 1939. [R. 3, 5-9.] The decision of the Tax Court was entered on January 10, 1955. [R. 25.] The case is brought to this Court by a petition for review filed on April 1, 1955. [R. 26-27.] Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

Statement of the Case.

1. Facts.

A stipulation of the parties [R. 19-22] was adopted by the Tax Court as its findings of fact. [R. 23.] As revealed by the stipulation and the exhibits thereto (which consist of the pertinent individual and partnership tax returns) the facts material to this appeal may be summarized as follows:

Taxpayers were husband and wife. They filed joint returns for the years 1948 and 1949. [R. 19; Stip. Exs. 1-A, 2-B.] During the same period the husband was associated with Joseph M. Schenck in a partnership (referred to herein as Arrowhead) which filed partnership returns for the fiscal years ended October 31, 1948 and 1949. The husband held a 50 per cent interest in the profits of the partnership. [R. 19-20; Stip. Exs. 3-C, 4-D.]

In 1948 taxpayers sustained a casualty fire loss. It is stipulated that this loss was of the type described under Section 117(j); and that the correct amount of the loss was $44,420.12. In 1949 the taxpayers sustained an individual proprietorship net loss in the amount of $106,214.98. It is stipulated that this loss, also, was of the type described under Section 117(j). [R. 20-21.]

The Arrowhead partnership sold the Arrowhead Springs Hotel prior to the tax years in question; and realized

gains therefrom in 1948 and 1949. It is stipulated that these gains were of the type described under Section 117(j) of the Internal Revenue Code of 1939. It is further stipulated that the taxpayer-husband's share of these gains for 1948 was $37,675.62, and his share for 1949 was $28,333.28. [R. 20-22.]

In their joint returns for 1948 and 1949 taxpayers reported taxpayer-husband's distributive share of the partnership capital gains and losses (which included partnership Section 117(j) gains and losses) adding such share to their individual capital gains and losses. The resulting capital gain was then reduced by fifty (50) per cent. Taxpayers individual Section 117(j) losses were deducted in full. [R. 20-22.]

2. Question Involved.

Was the Arrowhead partnership an entity for the purpose of determining gains or losses from the sales or exchanges of assets described in Section 117(j) I. R. C. (Appx., *infra*) and Respondents distributive share thereof? Stating the question differently, are gains and losses from sales or exchanges of Section 117(j) assets to be balanced at partnership level or at partner level?

3. Manner in Which Question Was Raised.

Upon auditing taxpayers' returns for 1948 and 1949 the Commissioner determined deficiencies upon the ground *inter alia* that taxpayers had improperly reported the taxpayer-husband's share of the Arrowhead partnership Section 117(j) gains. [R. 21-22.] The Tax Court ruled however that taxpayers manner of reporting the partnership Section 117(j) gains was correct. [R. 23-25.]

Argument of the Case.

1. Summary of Argument.

Respondents computed their gains and losses from sale or exchanges of assets described in Section 117(j) I. R. C. (Appx., *infra*), in the way intended by Congress and approved by the Commissioner. The partnership 117(j) transactions were aggregated with the result that the gains from such transactions exceeded the losses from such transactions. The net gain was then considered a long-term capital gain, segregated on the partnership return, and each partner's distributive share shown on page 4 of the partnership return. Respondents on their individual returns for both 1948 and 1949 reported Respondents-husband's share of the partnership capital gains and losses adding such share to their individual capital gains and losses. The resulting capital gain was then reduced by fifty (50%) per cent in accordance with Section 117(b) I. R. C. (Appx., *infra*). Respondents aggregated their individual Section 117(j) gains and losses and deducted the net loss in full.

Respondents contend that the entity theory of partnerships must be applied in computing the ordinary net income and the gains or losses from sales or exchanges of Section 117(j) assets of a partnership; that if the partnership's 117(j) transactions result in a loss, the loss is combined with the ordinary net income or loss of the partnership; that if the partnership's 117(j) transactions result in a gain, the gain then becomes a long-term capital gain and distributible to the partners as such; that the partner combines his distributive share of such gain with his other capital gains and losses in determining his taxable net income and in computing his tax under the alternative tax computation if applicable.

Respondents contend that the Commissioner's determination that Respondent-husband's distributive share of partnership 117(j) transactions be combined with Respondents individual 117(j) transactions is erroneous and illegal.

2. Detail of Argument.

The partnership in which Respondent-husband was a partner is an entity for the purpose of determining gains or losses from the sales or exchanges of assets described in Section 117(j), I. R. C. and the Respondent-husband's distributive share thereof, and therefore such gains or losses should not be aggregated with Respondents' individual Section 117(j) I. R. C. gains and losses in determining whether the Respondents have a net gain or loss under Section 117(j) I. R. C.

It has long been recognized that the Internal Revenue Code uses both the entity and aggregate theories in subjecting the income of partners to tax. In *Neuberger v. Commissioner,* 311 U. S. 83 (1940), at page 88, Mr. Justice Murphy stated, "In requiring a partnership informational return although only individual partners pay any tax, Congress recognized the partnership both as a business unit and as an association of individuals".

The aggregate theory is exemplified by Section 181 I. R. C. (Appx., *infra*) which requires partners to pay income tax upon partnership profits only in their individual capacity, and also by Section 182, I. R. C. (Appx., *infra*), which provides that long- and short-term capital gains and losses and ordinary income and losses retain their character after passing through the partnership into the returns of the individual partners.

Section 183 I. R. C. (Appx., *infra*) on the other hand, provides that the net income of the partnership shall be computed in the same manner as in the case of an individual. This section recognizes the partnership as an entity for the purpose of computing income and was undoubtedly enacted because of the universal practice of maintaining one set of books of account for a partnership. Section 187 I. R. C. (Appx., *infra*) recognizes the partnership as an entity wherein it requires an informational return to be filed by or for the partnership. Again Section 188 I. R. C. (Appx., *infra*) recognizes the entity theory in that it explains the method of correlating the payment of tax by a partner with the reporting of income by the partnership when the parter and the partnership have different taxable years. Section 190 I. R. C. (Appx., *infra*) fully recognizes the partnership as an entity for the purpose of allowing an amortization deduction on certain emergency facilities owned by the partnership.

The Courts have recognized the entity theory where a taxpayer retires from his partnership or sells his interest to an incoming partner. In such cases he is held to have capital gain or loss even though the gain or loss is attributable to the value of inventory or other noncapital assets of the partnership.

Commissioner v. Lehman, 165 F. 2d 383, cert. den. 334 U. S. 819;

Commissioner v. Smith, 173 F. 2d 470 affirm. 10 T. C. 398, cert. den. 338 U. S. 818;

Long v. Commissioner, 173 F. 2d 471 cert. den. 338 U. S. 818;

Dudley T. Humphrey, 32 B. T. A. 280.

The entity theory of partnerships has also been recognized by the Tax Court where a partnership continues after

one partner is bought out by other partners. The basis of property later sold by the partnership is not disturbed by the sale of one partner's interest.

Robert E. Ford, 6 T. C. 499.

In many other situations the Courts and Commissioner have recognized a partnership as an entity. A few of these situations follow: A partnership elects to write off intangible drilling expenses; a corporate partner is not entitled to take the eighty-five (85%) per cent credit on its share of dividends received by the partnership; a partnership makes a separate computation regarding percentage depletion; a partnership elects the cash or accrual method of accounting, the method of accounting for bad debts and the choice of a fiscal year; a partner looks only to his share of the partnership's net income in determining the limitation of his medical expenses and contributions.

It is Respondents' position (1) that Congress intended that Section 117(j) gains and losses of a partnership must be aggregated at the partnership level without reference to the partner's individual Section 117(j) gains and losses (which treatment would be consistent with the entity theory of partnerships) and, (2) that the Commissioner's contention that the partner's individual Section 117(j) gains and losses must be aggregated with his share of the partnership's Section 117(j) gains and losses (which treatment would be consistent with the aggregate theory of partnerships) is improper.

Let us first consider the pertinent provisions of the Internal Revenue Code. Section 183(b) provides for a segregation on the partnership returns of ordinary net income from gains and losses from sales or exchanges of *capital* assets. (It should be noted that there is no provision that gains or losses from sales or exchanges of

Section 117(j) assets be so segregated.) Section 117 I. R. C. which defines *capital* assets in effect divides all assets into three classifications:

1. All property except stock in trade, property includible in inventory, property held primarily for sale, depreciable property, or real property used in a trade or business. The assets not excluded are called capital assets.

2. All property excluded from group one, except property used in the trade or business as defined in Section 117(j) I. R. C. These assets are called non-capital assets.

3. All property used in the trade or business, subject to allowance for depreciation, held for six months, and certain real property. These assets are not capital assets and for convenience are called Section 117(j) assets.

The only assets involved in the case at bar are Section 117(j) assets.

Inasmuch as Section 183 requires a segregation of only *capital* gains and losses, the question then is—by what authority must gains or losses from the sale or exchange of assets of a type described in Section 117(j) be segregated?

A careful reading of Section 117(j) I. R. C. shows that gains and losses from the sale or exchange of Section 117(j) assets are "considered as gains and losses from sales or exchanges of capital assets held for six months" under certain circumstances and that such gains or losses are considered as ordinary gains or losses under certain other circumstances. If the circumstances are present which convert the gains and losses from the sale of

Section 117(j) assets into *capital* gains and losses, *i.e.*, if the gains from the sale of 117(j) assets plus gains from conversion of such assets and capital assets held more than six months exceed the losses from such sales, then such gains and losses are capital gains and come within Section 183(b) and must be segregated.

If the circumstances which convert the gains and losses from the sale of Section 117(j) assets into capital gains and losses are *not* present, *i. e.*, if the gains do *not* exceed the losses, then the gains and losses are *not* considered as gains and losses from the sale or exchange of *capital* assets. If such gains and losses are not *capital* gains and losses, then Section 183(b) does not require or permit their segregation and there is no other provision requiring or permitting such segregation. The net loss must then be reported upon the partnership return as ordinary loss or as a reduction of ordinary income in arriving at net ordinary income.

Respondents contend that this is an express recognition by Congress of the entity theory of partnerships. If Congress had intended that partnership 117(j) gains and losses be segregated and carried over into the individual return of a partner and there combined with the partner's other 117(j) gains and losses Congress would have amended Section 183(b) to provide that *capital* gains and losses and *117(j)* gains and losses be segregated. This was not done in the Revenue Act of 1942 when Section 117(j) was enacted or in any subsequent Revenue Act.

Let us next consider the position of the Commissioner in similar situations.

That Congress intended Section 117(j) to be applied to the partnership as an entity has been admitted by the

Commissioner in his treatment of elections by taxpayers that the cutting of timber be considered as a sale or exchange of the timber. Section 117(j) provides that the term "property used in the trade or business" includes timber if the taxpayer owned or had a contract right to cut the timber for more than six months prior to the beginning of the year. If the taxpayer so elects upon his return, the cutting of such timber is considered as the sale or exchange of such timber cut during the year. *In I. T. 3713, 1945 C. B. 178,* the Commissioner ruled that with respect to partnership items, the right of election under 117(k) to have the cutting of timber considered as a sale or exchange of such timber extends to and must be exercised by the partnership. The reasoning of the Commissioner in that ruling is clear and concise and most certainly applies to other assets described in Section 117(j) as well as to timber. The reasoning of the Commissioner is set forth verbatim:

> "Pursuant to the provisions of Section 117(k)(1) of the Code, *supra*, the election to secure the benefits therein provided must be made by the taxpayer.
>
> "Section 3797(a)(14) of the Code defines 'taxpayer' as follows: (14) Taxpayer.—The term 'taxpayer' means any person subject to a tax imposed by this title.
>
> "Section 181 of the Code provides as follows:
>
> "Section 181 PARTNERSHIP NOT TAXABLE—Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.
>
> "In view of the provisions of Section 181 of the Code, *supra,* a partnership is not taxable as such and may not be classified as a 'taxpayer', as that term is defined in Section 3797(a)(14) of the Code, *supra.* Nevertheless, a partnership is treated as a unit in

> Section 183 of the Code, under which Section the partnership net income must be computed, and in Section 187 of the Code, which requires that every partnership shall make a return for each taxable year of its gross income and deductions, together with other information for the purpose of carrying out the provisions of Chapter 1 of the Code, relating to income tax. Also, under Section 29.187-1 of Regulations 111, a partnership is required to adopt its own annual accounting period. *In order to accomplish a proper reflection of partnership gross income and deductions in the ascertainment of partnership net income, partnership items must be recognized as unit items returnable as such in the partnership return.* (Emphasis added) It follows, therefore, that in so far as partnership items are concerned, the right to the election provided for in Section 117(k)(1) of the Code, *supra,* upon which there depends a benefit granted to taxpayers generally, must be considered as available to a partnership, and the right to the election must be exercised by it."

In the case of *John G. Scherf, Jr. v. Commissioner,* 20 T. C. 346 (Docket No. 31267), more fully discussed in a later paragraph in this brief, the Commissioner was taking the opposite position he is taking in the case at bar. In the *Scherf* case, the Commissioner argued that the Petitioner's full distributive share of the gain as reported on the partnership return must be included in Petitioner's income. Petitioner there had attempted to report his distributive share of certain capital gains on the installment basis but the Tax Court decided in favor of the Commissioner.

Let us lastly consider the various decisions pertaining to the case at bar.

Petitioner in its brief relies heavily upon the decision of the Supreme Court in *Neuberger v. Commissioner of Internal Revenue,* 311 U. S. 83, but that case is distinguishable from the case at bar. The *Neuberger* case arose under Section 23 of the 1932 Revenue Act which dealt with losses from sales of stocks and bonds which were not capital assets. The Court stated "The basic and narrow question is whether, in computing the income of an individual partner, the word 'gains' in Section 23(r)(1) includes gains from sales or exchanges of partnership stocks and bonds which are not capital assets as defined in Section 101." The year involved was 1932 which was six years before the law permitted the offsetting of an individual's capital gains and losses against his distributive share of the partnership's capital gains and losses. The case was decided in 1940, two years before Section 117(j) was enacted into law. At most the case is authority for the proposition that the entity theory of partnerships does not apply where Congress plainly intended otherwise. In the case at bar Petitioner has not shown that Congress intended that the entity theory should not apply to Section 117(j) gains and losses.

Respondent contends that Congress intended that the entity theory *should* apply by not requiring segregation on the partnership information return of Section 117(j) transactions as well as capital transactions. The Tax Court has not cited the Neuberger decision in the *Scherf* case, 20 T. C. 346, the *Ammann* case, 22 T. C. 1106, or in its decision of the case at bar. Either the government has not seen fit to cite the *Neuberger* case or the Tax Court has believed it to be distinguishable.

In *John G. Scherf, Jr. v. Commissioner,* 20 T. C. 346 decided on May 14, 1953, the Tax Court stated at page 347:

"An understanding of the roll of a partnership in our income tax laws is essential to the proper analysis of this case. * * * The partnership return is more than just an information return. It has consequences that go beyond the mere description to the Commissioner of profits of the enterprise."

In that case a partnership sold its business and assets consisting of machinery, equipment, and good will. Although the Court made no point of it, it should be noted that the machinery and equipment were Section 117(j) assets. The partnership reported the gain as a long-term capital gain and Petitioner there attempted to report his share of the partnership net long-term capital gain on the installment basis. The Court stated that Petitioner apparently contended that capital gains form no part of the partnership return but the Court drew a distinction between segregation of capital gains and elimination of capital gains. The Court stated at page 350:

"Section 182 carries out the theory of 'segregation' rather than 'elimination' and provides the machinery for allocating to each partner his distributive share of capital gain (whether short-term or long-term) as well as ordinary income. If capital gain were eliminated from the partnership return, there would be no reason at all for the provisions of Section 182(a) and (b). Indeed, the very act of segregating the capital gains and losses as provided in Section 183(b) requires a computation by the partnership, whereby the amount of gain or loss is determined by reference to the partnership basis for the assets, Section 113(a) 13; the result thus obtained is reflected in the segregated income according to the method of accounting properly applicable thereto, and the distributive share of each partner is then allocated to him in accordance with Section 182. The

segregation provisions in Section 183(b)(1), relied upon by petitioner, were never intended to have any such unusual consequences as those urged upon us by him. Such consequences would be disruptive of the entire statutory scheme and would render nugatory the provisions of Section 182(a) and (b)."

Respondents submit that Section 44(b) and Section 182 are both "relief" provisions. Although one section grants relief by permitting the reporting of income over a period of years while the other permits the reporting of only one-half the gain and all of the losses from certain transactions, both provisions should be accorded similar treatment when incurred by a partnership.

In *Ammann v. Commissioner,* 22 T. C. 1106, the facts are identical with those in the case at bar except it was the partnership which sustained the losses and the petitioner who realized the gain. Only Section 117(j) assets were involved. The Tax Court held that Section 182(c) required the petitioner to report his share of the partnership loss as ordinary loss. It stated:

"Section 117(j)(2)(A) refers to the computation of net income and is some further indication that Section 117(j) refers to the gains and losses of the taxpayer or the unit (partnership) for which 'net income,' gains, and losses are separately computed and reported for income tax purposes and does not mean that the computation is not made in the case of a partnership but is made only on the basis of the return of each separate partner. The Commissioner has pointed to no statutory or other authority supporting his contrary contention. Section 117(j) is not limited to a 'taxpayer' as contended by the Commissioner, but applies to a partnership as well."

Conclusion.

Respondents submit that the pertinent provisions of the Internal Revenue Code, the position of the Commissioner in similar situations, and the various decisions discussed in this brief all sustain the Tax Court's decision; that the Tax Court's decision is correct and should be affirmed.

Respectfully submitted,

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APPENDIX.

Statute and Regulations Involved.

Internal Revenue Code of 1939:

Section 117(a) Definitions—As used in this chapter,

(1) Capital Assets.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in Section 23(l), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or before March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

(2) Short-term Capital Gain.—The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than six (6) months, if and to the extent such gain is taken into account in computing net income;

(3) Short-term Capital Loss.—The term "short-term capital loss" means loss from the sale or exchange of a capital asset held for not more than six (6) months, if and to the extent such loss is taken into account in computing net income;

(4) Long-term Capital Gain.—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than six (6) months, if and to the extent such gain is taken into account in computing net income;

(5) Long-term Capital Loss.—The term "Long-term capital loss" means loss from the sale or exchange of a capital asset held for more than six (6) months, if and to the extent such loss is taken into account in computing net income;

(6) Net Short-term Capital Gain.—The term "net short-term capital gain" means the excess of short-term capital gains for the taxable year over the short-term capital losses for such year;

(7) Net Short-term Capital Loss.—The term "net short-term capital loss" means the excess of short-term capital losses for the taxable year over the short-term capital gains for such year;

(8) Net Long-term Capital Gain.—The term "net long-term capital gain" means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year;

(9) Net Long-term Capital Loss.—The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year.

(10) Net Capital Gain.—

(A) Corporations.—In the case of a corporation, the term "net capital gain" means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges; and

(B) Other Taxpayers.—In the case of a taxpayer other than a corporation, the term "net capital gain" means the excess of (i) the sum of the gains from sales or exchanges of capital assets, plus net income of the taxpayer or $1,000, whichever is smaller, over (ii) the losses from such sales or exchanges. For purposes of this subparagraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets. If the tax is to be computed under Supplement T, "net income" as used in this paragraph shall be read as "adjusted gross income."

(11) Net Capital Loss.—The term "net capital loss" means the excess of the losses from sales or exchanges of capital asets over the sum allowed under subsection (d). For the purpose of determining losses under this paragraph, amounts which are short-term capital losses under subsection (e)(1) shall be excluded.

(b) Percentage Taken Into Account.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss and net income:

100 per centum if the capital asset has been held for not more than six (6) months;

50 per centum if the capital asset has been held for more than six (6) months.

* * * * * * * *

Section 117(j) Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business—

(1) Definition of Property Used in the Trade or Business.—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1), held for more than six (6) months, and real property used in the trade or business, held for more than six (6) months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

(2) General Rule.—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than six (6) months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than six (6) months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent

taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than six (6) months shall be considered losses from a compulsory or involuntary conversion.

(k) Gain or loss Upon the Cutting of Timber.—(1) If the taxpayer so elects upon his return for a taxable year, the cutting of timber (for sale or for use in the taxpayer's trade or business) during such year by the taxpayer who owns, or has a contract right to cut, such timber (providing he has owned such timber or has held such contract right for a period of more than six months prior to the beginning of such year) shall be considered as a sale or exchange of such timber cut during such year. In case such election has been made, gain or loss to the taxpayer shall be recognized in an amount equal to the difference between the adjusted basis for depletion of such timber in the hands of the taxpayer and the fair market value of such timber. Such fair market value shall be the fair market value as of the first day of the taxable year in which such timber is cut, and shall thereafter be considered as the cost of such cut timber to the taxpayer for all purposes for which such cost is a necessary factor. If a taxpayer makes an election under this paragraph such election shall apply with respect to all timber which is owned by the taxpayer or which the taxpayer has a contract right to cut and shall be binding upon the taxpayer for the taxable year for which the election is made

and for all subsequent years, unless the Commissioner, on showing of undue hardship, permits the taxpayer to revoke his election; such revocation, however, shall preclude any further elections under this paragraph except with the consent of the Commissioner,

(2) In the case of the disposal of timber (held for more than six (6) months prior to such disposal) by the owner thereof under any form or type of contract by virtue of which the owner retains an economic interest in such timber, the difference between the amount received for such timber and the adjusted depletion basis thereof shall be considered as though it were a gain or loss, as the case may be, upon the sale of such timber.

*   *   *   *   *   *   *   *

Section 181. Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

Section 182. In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As part of his gains and losses from sales or exchanges of capital assets held for not more than six (6) months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than six months.

(b) As part of his gains and losses from sales or exchanges of capital assets held for more than six (6) months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than six (6) months.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in Section 183(b).

Section 183. (a) General Rule.—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b), (c) and (d).

(b) Segregation of Items:—

(1) Capital Gains and Losses.—There shall be segregated the gains and losses from sales or exchanges of capital assets.

(2) Ordinary Net Income or Loss.—After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

(c) Charitable Contributions.—In computing the net income of the partnership the so-called "charitable contribution" deduction allowed by Section 23(o) shall not be allowed; but each partner shall be considered as having made payment, within his taxable year, of his distributive portion of any contribution or gift, payment of which was made by the partnership within its taxable year, of the character which would be allowed to the partnership as a deduction under such section if this subsection had not been enacted.

(d) Standard Deduction.—The standard deduction provided in section 23 (aa) shall not be allowed.

Section 187. Every partnership shall make a return for such taxable year, stating specifically the item of its gross income and the deductions allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

Section 188. If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership, in computing the net income of the partner for his taxable year, shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the partner.

Section 190. In the case of emergency facilities of a partnership, the benefit of the deduction for amortization allowed by section 23(t) shall not be allowed to the members of a partnership but shall be allowed to the partnership in the same manner and to the same extent as in the case of an individual.